

Dissertation

Money Laundering:

Fiscal & Economic Implications

and

**The Potential Impact of the Financial
Intelligence Centre Act (FICA)**

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Supervisor: Prof W Geach

University of KZN

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Submitted by: Asogan Naicker
Student No.: 2003/02/941

Executive Summary

Money laundering is the act of converting money gained from illegal activity, such as drug smuggling, into money that appears legitimate and in which the source cannot be traced to the illegal activity. Criminal proceeds also include that which is derived from tax evasion. Estimates of the scale of money laundering globally range between 2 and 5% of the worlds Gross Domestic Product. Another study refers to money laundering as the third largest industry globally.

Money laundering has devastating consequences for countries individually and for the global economy as a whole. Potential macroeconomic consequences include inexplicable changes in money demand, greater prudential risks to banks' soundness, contamination effects on legal financial transactions and greater volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers.

A number of initiatives have been established for dealing with the problem at international level. Amongst the most significant is the formation of the Financial Action Task Force (FATF), a body that was established by the G-7 nations in 1989 to develop a coordinated international

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response to money laundering. South Africa was recently accepted as a full member of the FAFT, having satisfied the FATF recommendations with the implementation of a Financial Intelligence Centre Act.

The provisions of the Act came into effect on 1 June 2003. The Act imposes reporting obligations on accountable institutions like banks, insurance companies, estate agent and casinos. The Financial Intelligence Centre (FIC) is established by the Act in order to identify the proceeds of unlawful activities and to combat money-laundering activities. It aims to do so by making information collected by it available to investigating authorities (South African Police, Scorpions, Asset Forfeiture Unit etc. including SARS). The FIC will in the course of its functions build up a database of information, which it will retain and utilise to support the above-mentioned bodies in the performance of their functions.

The FICA creates a special relationship particularly with SARS. The FIC data will assist SARS to combat tax evasion and to collect taxes more effectively. The Act explicitly requires all institutions to report any transactions that may be relevant to the investigation of any evasion or attempted evasion of any tax, levy or duty.

Money laundering by its very nature does not lend itself to being accurately measured but based on estimates discussed above, this can amount to a substantial loss to the fiscus. The estimated range of between 2 and 5% of the world's GDP would translate to between R24 and R60 billion being laundered annually in South Africa. If one applies the minimum marginal tax rate of 18%, one arrives at a potential loss of between R4.32 and R10.8 billion to the fiscus.

Whilst the new Financial Intelligence Centre Act cannot totally eradicate the laundering of undeclared or criminal proceeds, the many obligations now placed on accountable institutions in terms of the Act is most likely to be a further deterrent or obstacle to tax evasion.

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Chapter 1

Introduction

Over the past two decades, the international campaign against money laundering has gained momentum due to concerns about organised crime, tax evasion and, more recently, terrorism. Closer to home, South Africa has recently joined other developed countries by introducing legislation that further narrows the scope to launder money in our country. Many people may think money-laundering legislation is no concern of theirs, but if one has dealings with attorneys, estate agents, stockbrokers, unit trust management companies, banks, insurance companies, financial advisers or asset managers, the Financial Intelligence Centre Act affects you.

Money laundering can be broadly defined as any activity that has, or is likely to have, the effect of concealing the movement of the proceeds of unlawful activities. That encompasses a wide range of possibilities, and the Financial Intelligence Centre Act of 2001 (FICA), which came into effect on 30 June 2003, casts a very wide net to catch them all. This it does by placing special obligations on all institutions that carry out financial

transactions on behalf of clients. Since June 30, these "accountable institutions" (Annexure 1), as the legislation calls them, have to keep much more detailed records relating to their clients and the sources of their funds. And not only do they have to gather the information, but they have an obligation to verify it, too. This means that every time one enters into a new business relationship or transacts for the first time with a company that is classified as an accountable institution, one needs to provide more information than was required in the past - with the documentary evidence to support it.

Apart from gathering and verifying information routinely, accountable institutions are obliged to report to the Financial Intelligence Centre any transactions that may be deemed "suspicious transactions", in that they are being used, or are suspected of being used, for money-laundering purposes. A transaction is regarded as suspicious if, for example, it is known or suspected to have no legitimate business purpose or is relevant to an investigation of tax evasion or attempted tax evasion.

The study first examines the concept of money laundering with an emphasis on its economic and fiscal implications, generally first, and then more specifically in a South African context. This initial discussion creates a

foundation for exploring the impact of the Financial Intelligence Centre Act (FICA) on the fiscus, which is an important consideration in this study.

The chapter that follows defines the term money laundering and offers insights into the actual methods of money laundering including a typical profile of a money launderer. Chapters 3 and 4 examine the problem from a global perspective. The magnitude and scale of the problem is discussed in Chapter 3. Chapter 4 focuses on international efforts to combat money laundering including developments in the United States and United Kingdom. The devastating implications of money laundering for a country's economy, society, political system and overall development are considered in Chapter 5. The South African context in chapter 6 explains our legislative record with regard to money laundering and contains a discussion on money laundering trends unique to us in South Africa. The Financial Intelligence Centre Act, which is relatively new to us, is analysed in chapter 7. Before concluding the study, an attempt is made in chapter 8 to place in perspective the potential impact of this new legislation on the fiscus.

Chapter 2

Money Laundering

2.1 A Definition

Money laundering has been given many definitions. One definition is that money laundering is the act of converting money gained from illegal activity, such as drug smuggling, into money that appears legitimate and in which the source cannot be traced to the illegal activity (Stressens: 2000). Another author (Madinger: 1999) defines it as follows: "The phrase 'money laundering' covers all procedures to change the identity of illegally obtained money so that it appears to have originated from a legitimate source. The official definition by the United Nations is "Money laundering is the process by which criminals attempt to conceal the true origin and ownership of the processes of their criminal activities. If undertaken successfully, it also allows them to maintain control over those proceeds and, ultimately, to provide a legitimate cover for their source of income (Najajima: 1999).

A summarised definition of money laundering would therefore be that money laundering is a process by which

the proceeds of crime are hidden from investigators, moved around financial and economic systems in order to make tracing them more difficult and then spent as if they are legitimate funds. It should be noted at this stage that money laundering refers to the proceeds of any crime that results in the proceeds being laundered or cleansed, although early money laundering control efforts focused on drug proceeds.

Money laundering is, in essence, the process of concealing the nature, source or location of criminal proceeds including tax evasion. This process is of critical importance, as it enables the criminal to enjoy these profits without jeopardizing their source. When a criminal activity generates substantial profits, the individual or group involved must find a way to control the funds without attracting attention to the underlying activity or the persons involved (Rider: 1996)

2.2 How is money laundered?

In the initial or placement stage of money laundering, the launderer introduces his illegal profits into the financial system. This might be done by breaking up large amounts of cash into less conspicuous smaller sums that are then deposited directly into a bank account, or by

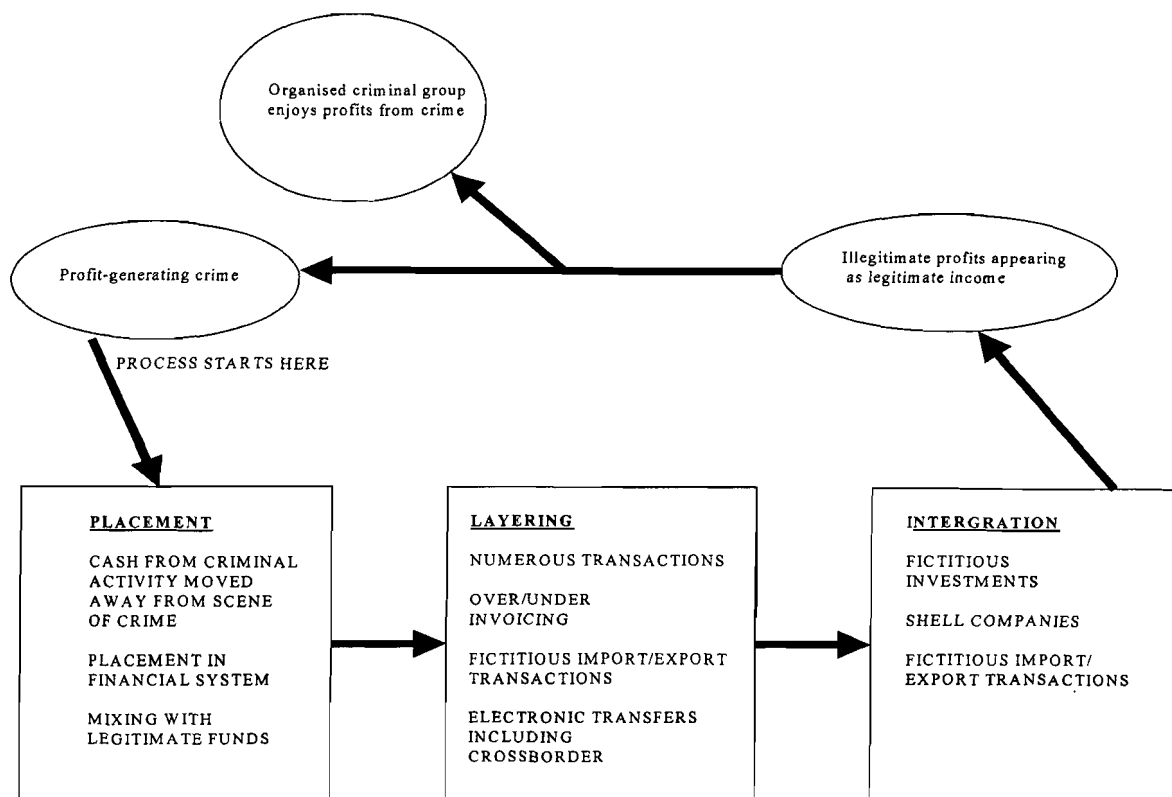
purchasing a series of monetary instruments (cheques, money orders, etc.) that are then collected and deposited into accounts at another location (Zeldin: 1998).

After the funds have entered the financial system, the second - or layering - stage takes place. In this phase, the launderer engages in a series of conversions or movements of the funds to distance them from their source. The funds might be channelled through the purchase and sales of investment instruments, or the launderer might simply wire the funds through a series of accounts at various banks across the world (Zeldin: 1998). This use of widely scattered accounts for laundering is especially prevalent in those jurisdictions that do not co-operate in anti-money laundering investigations (Froomkin: 1997). In some instances, the launderer might disguise the transfers as payments for goods or services, thus giving them a legitimate appearance.

Having successfully processed his criminal profits through the first two phases of the money laundering process, the launderer then moves them to the third stage - integration - in which the funds re-enter the legitimate economy (Zeldin: 1998) The launderer might

choose to invest the funds into property, luxury assets, or business ventures.

The process is illustrated diagrammatically below.



Source: P Smit: Clean Money Suspect Source 2001.

2.3 Profile of the Money Launderer

The term money launderer obviously has negative connotations and the practice of money laundering conjures up a shady world of men in pinstriped suits

claiming to be "bankers" and acting for ill-defined customers and vague offshore businesses (Carr: 1989). The fact that many of the cases that have become known involve exactly such scenarios has tended to reinforce such perceptions. These professional financial managers, trust officers, attorneys and bankers (those who fit the profile of the modern money launderer), who assist criminals and terrorists to retain their ill-gotten gains and further their illicit enterprises, cannot be distanced from the crooks they serve. When the money is the product of drug trafficking or even a bank robbery, then the stigma that can attach to those who assist in the laundering process is very much the same. These professionals that are actively involved in providing such services may never transgress the law in many cases, the laundering may well involve funds that are not referable to a crime or other form of misconduct (Richards: 1999).

Chapter 3

The International Problem

3.1 Scale of the problem

Many attempts have been made to quantify the size of the money laundering industry and the effects on the world's economy of this industry. The scale of the activity is also difficult to estimate because it is secretive and misleading by nature. It is therefore only possible to provide figures on the incidence of money laundering based on estimates and speculation (Black: 1988). There are, however, a few indicators from which conclusions on the incidence of money laundering can be drawn. These include the number of suspicious transactions identified by financial institutions, the number of organised criminal groups identified by law enforcement authorities, the number of prosecutions for money laundering activities and forfeitures of proceeds of criminal activities, and global economic trends concerning trade and flow of funds (Smit: 1997).

As well as making extensive use of cash, serious and organised criminals will often go to great lengths to avoid arousing suspicion when dealing with the regulated

financial sector as suspicious financial transactions, including cash payments, are subject to a disclosure regime. However, use of the regulated sector is unavoidable if serious and organised criminals wish to legitimise their criminal proceeds. The International Monetary Fund estimates that the aggregate size of money laundering in the world could be somewhere between two and five percent of the world's gross domestic product (Hinterseer: 1997). Using 1996 statistics, these percentages would indicate that money laundering ranged between US Dollar (USD) 590 billion and USD 1.5 trillion. The lower figure is roughly equivalent to the value of the total output of an economy the size of Spain (Hinterseer: 1997). Another study estimated that global money laundering involves as much as USD 300 billion annually (Black: 1990).

The influence wielded by criminal groups controlling such incredible wealth has led world leaders to deem money laundering a geopolitical problem, which, if unchecked, threatens the political fabric of fragile democracies and democratic institutions everywhere (Paradise: 1998). In another article (Biros: 1995) money laundering was referred to as the third largest industry globally: Money laundering is said to be the third largest industry by value worldwide. Research in the United States has shown

that 90% of currency bills in circulation are contaminated with narcotics. In the United Kingdom, similar research showed 40% to be contaminated (Bentham: 1998). Other research in the United Kingdom has shown that 80% of property related crime is committed to fund a drug habit. A single user shooting one shot of heroin a day needs to spend £28,500 each year just to feed his personal consumption. In order to fund that amount, he will turn to robbery, dealing in drugs, prostitution and theft. In the United Kingdom, stolen household and office goods realize approximately one-third of their new value (Reuter: 1996).

HM Customs and Excise (UK) recently estimated the annual proceeds from crime in the UK at anywhere between £19 billion and £48 billion, with £25 billion possibly being a realistic figure for the amount actually laundered. Based on the January 2000 International Monetary Fund estimate of undeclared economic activity in the UK representing around 13 percent of Gross Domestic Product, £25 billion would equate to roughly one fifth of all undeclared economic activity (Elliot: 1997)

Another study (Walker: 1995) has looked at the scarce data available to measure money laundering, and assembled a number of estimates of the extent of money laundering in and through Australia. Between \$1000 and \$4500 million

of hot money is believed to be generated in Australia and laundered, either in Australia or sent overseas. Perhaps the most likely figure is around \$3500 million. Under any assumption, the greatest components of this quantum are sourced by fraudulent offences followed by the drugs trade - virtually nothing else matters (Walker: 1995).

3.2 Tax Havens

In October 1986, the United States became the first country in the world to criminalize money laundering. In the next decade, each of the world's leading financial centers followed suit, enacting anti-laundering laws and enlisting the aid of financial institutions in detecting and preventing money laundering activities. Forced by these efforts to find new avenues for laundering illicit proceeds, money launderers turned to the privacy, confidentiality, minimal regulation and security of small islands and territories or tax havens, as they are also known (Hampton: 1996)

For many tax havens like Isle of Man, Jersey and Guernsey international banking is an important segment of their economic well-being. It provides jobs, international exposure and much needed revenue for their treasuries (United Nations: 1998). It is a clean, desirable industry. In order to attract money offshore,

banks in the small countries must offer a more favorable banking environment. This translates to minimum taxes and maximum confidentiality, which in turn lead to a higher risk of infiltration by criminally derived money seeking to be laundered. The service offered always includes confidentiality. This is especially true for the wealthy from other Third World countries seeking a safe haven for their capital. As a consequence, international bankers in tax havens commonly assist their clientele in achieving their confidentiality goals through such legal vehicles as corporations and trusts (Maynard: 1998). These vehicles are used for legitimate reasons, notably tax and estate planning. Indeed, avoidance of tax liability and estate complications in a foreign country is certainly understandable and lawful goals, which are preferably obtained from tax preferential jurisdictions.

This type of environment offers opportunities for certain forms of money laundering. By its very nature, international banking lends itself to large, non-cash deposits and to more sophisticated forms of financial transactions using electronic methods to transfer large sums of money to both offshore and onshore destinations (Bosworth-Davies: 1992).

Studies have shown that these tax havens contribute little to the surrounding economy and do not form the basis for sustained economic growth (Masciandaro: 1998). The tax havens are virtually costless to establish, and therefore competition among them for customers is severe. Second, because tax havens provide little value-added services, such financial centers generate almost no economic demand for the surrounding "real" economy in terms of employment, goods, or services (Musalem: 1999).

Chapter 4

International efforts to combat Money laundering

For many years the fight against money laundering has been an essential part of the overall struggle to combat illegal narcotics trafficking and the activities of organized crime. During that time, the key issue involved in the anti-money laundering effort has been ensuring that the critical piece or pieces of information make it to the right people - the investigators and prosecutors charged with putting criminals behind bars and taking their illegally obtained wealth away - in a timely and useful manner (Alexander: 1998). The information needed to support anti-money laundering investigations often involves a wide range of human activity beyond that based purely on criminal motivation. Countering money laundering effectively requires not only knowledge of laws and regulations, investigation, and analysis, but also of banking, finance, accounting and other related economic activities. Money laundering is after all an economic phenomenon; launderers rely to a certain extent on already existing financial and business practices (and the lack of understanding of these by the law enforcement community) as a way of hiding illegally obtained funds. Anti-money laundering investigations conceivably touch a

number of law enforcement agencies within a particular jurisdiction. This along with the fact of ever-present resource limitations means that a completely effective, multi-disciplined approach for combating money laundering is often beyond the reach of any single law enforcement or prosecutorial authority (Savona: 1997)

In many cases, there is also reluctance on the part of financial institutions to provide to government authorities information that might be related to but is not obviously indicative of a crime. One may add to these restrictions on information exchange in certain instances, the unwillingness or inability to share such information among relevant government agencies and the seemingly insurmountable obstacles to rapid exchanges of information with foreign counterparts. All of these barriers to information exchange directly affect the outcome of anti-money laundering investigations. Since money is constantly changing hands the crime of money laundering may not become completely obvious until many or all of the pieces are put together (Pheiffer: 1998)

The task of Financial Intelligence Units worldwide was after 11 September 2001, to include combating financing of terrorism and to count on a virtually immediate exchange of information. This information exchange has to

be at an early point after possible detection of a crime - the so-called "pre-investigative" or intelligence stage. Large-scale money laundering schemes invariably contain cross border elements. Since money laundering is an international problem, international co-operation is a critical necessity in the fight against it (Herbert: 2002).

A number of initiatives have been established for dealing with the problem at the international level. International organizations, such as the United Nations or the Bank for International Settlements, took some initial steps at the end of the 1980s to address the problem (Price Waterhouse Coopers: 2002). The most significant developments in this regard, however, was the formation of the Financial Action Task Force and the Egmont group. A discussion follows on these two important organizations.

4.1 Financial Action Task Force on money laundering (FATF)

A major initiative in 1989 to counter money laundering was the establishment of the Financial Action Task Force on money laundering (FATF) by the G-7 Summit in Paris to develop a co-ordinated international response (Gilmore:

1999). One of the first tasks of the FATF was to develop recommendations, forty in total. The forty recommendations, which were revised in 1996, are a comprehensive blueprint for action against money laundering (United Nations: 1997). They cover the criminal justice system and law enforcement; the financial system and its regulation; and international co-operation. Each FATF member has made a firm political commitment to combat money laundering based on them. The 40 Recommendations have come to be recognised as the international standard for anti-money laundering programmes (Parlour: 1995).

A number of non-FATF Member countries have used them in developing their efforts to address the issue. Members of the FATF include 29 countries and jurisdictions including the major financial centre countries of Europe, North and South America, and Asia as well as the European Commission and the Gulf Co-operation Council. The FATF works closely with other international bodies involved in combating money laundering. While its secretariat is housed by the Organisation for Economic Co-operation and Development (OECD), the FATF is not part of the OECD. However, where the efforts of the OECD and FATF complement each other, such as on bribery and corruption or the functioning of the international financial system,

the two secretariats consult with each other and exchange information (United Nations: 1996) The OECD is a representative body of the world's industrial powers.

4.2 The Egmont Group

Despite the fact that countries created their own Financial Intelligence Units (FIU's) in several jurisdictions throughout the world during the first years of the 1990s, their creation was still at first seen as isolated and related to the specific needs of those jurisdictions establishing them (Levi: 1997). Since 1995, a number of FIU's began working together in an informal organization known as the Egmont Group (named for the location of the first meeting at the Egmont-Arenberg Palace in Brussels). The groups membership has now grown to 94 Financial Intelligence Units (FIU) from different countries. The goal of the Group is to provide a forum for FIU's to improve support to their respective national anti-money laundering programmes. This support includes expanding and systematizing the exchange of financial intelligence information, improving expertise and capabilities of personnel of such organizations and fostering better communication among FIU's through application of technology (Graycar: 1996).

In a June 1997 meeting held in Madrid, Spain and at which 35 countries and 5 international organizations were present, the Egmont Group made significant steps forward in several areas. Perhaps the most important of these was the adoption by the Group of its Statement of Purpose, a document that describes the work accomplished so far, as well as its current goals within the framework of national and international anti-money laundering efforts. The FIU definition adopted in Rome was applied to all participating agencies - 28 of them were found to meet it - and this definition was incorporated into the Statement of Purpose (Sheptycki: 1995).

4.3 The Initiatives of UK and USA

The United Kingdom and the United States of America were amongst the first countries to implement internal systems to combat money laundering. These initiatives are discussed below.

4.3.1 United Kingdom

In Britain, the Drug Trafficking Offenses Act of 1986 made the laundering of the proceeds of drug related crimes. The Prevention of Terrorism (Temporary Provisions) Act of 1989 also made it an offense to launder the funds of terrorist organizations (Levi:

The Egmont Group examined the functions of the various FIU's and like agencies so as to determine those missions and functions that are carried out in common. The Egmont Group came to an agreement on the definition of an FIU, a definition that will likely facilitate the establishment of new units by setting a minimum standard for such a unit. According to this definition, a financial intelligence unit is "a central, national agency responsible for receiving (and, as permitted, requesting), analyzing and disseminating to the competent authorities, disclosures of financial information: (i) concerning suspected proceeds of crime, or (ii) required by national legislation or regulation, in order to counter money laundering" (Thony: 1996).

The definition also helped create a specific identity for the Egmont Group as distinct from FATF or other international bodies concerned with money laundering. The definition was meant to be specific enough to distinguish these agencies from other types of government authorities, yet it had to be generic enough to include the many variations of these units. Since the Egmont Group adopted this definition, it has increasingly become the standard against which newly forming units are measured.

1995). The United Kingdom authorities have recognized that London's financial markets are of great importance, not only in relation to the U.K. economy, but also in relation to global financial markets. They have also seen the need to protect the financial and operational integrity of those markets. The provisions relating to the laundering of the proceeds of drug trafficking have been consolidated and re-enacted in the Drug Trafficking Act 1994. The 1994 Act provides that it is an offense for anyone to assist drug traffickers to launder money by assisting them to retain or control the benefits of their criminal activity, even if this merely amounts to providing advice (Mitchell: 1996).

The U.K. is also an attractive target for money launderers. The attraction for the money launderer lies in the fact that London's financial markets have the necessary breadth, depth and openness to be useful at all stages of the money laundering process, whether it is placement, layering or integration. This attraction has been increased by the introduction of the European Union's single market in banking, investment services and insurance and the lowering of controls and barriers to free movement of goods, services, people and capital around Europe (Magliveras: 2002)

4.3.2 United States

The first time in the world that any nation enacted a specific law against money laundering was in the fall of 1986 when President Ronald Reagan signed the Money Laundering Control Act. This Act has subsequently been expanded in each election year (including elections for Congress 1988, 1990, 1992 and 1994), which suggests at the very least some political consideration for the implementation and strengthening of money laundering laws (Mckenzi: 1991). The law was broader than the common usage of the phrase money laundering. It is not limited to cash, but includes all monetary instruments and all financial transactions. Indeed, in the United States, dirty money never loses its taint and is never cleansed. In essence, the law criminalizes banking services to crooks. Each movement of dirty money is a separate crime (Mckenzi: 1991).

Economic Effects of Money Laundering

5.1 Macroeconomic impact of money laundering

The estimates of the present scale of money laundering transactions are almost beyond imagination—2 to 5 percent of global GDP would probably be a consensus range. This scale poses two sorts of risks: one prudential, the other macroeconomic (Quirk: 1996). Markets and even smaller economies can be corrupted and destabilized. Evidence of this has been seen in countries and regions, which have harbored large-scale criminal organizations (Quirk: 1996)

In the beginning, good and bad monies intermingle, and the country or region appears to prosper, but in the end there is a tremendous risk that only the corrupt financiers remain. Lasting damage can clearly be done, when the infrastructure that has been built up to guarantee the integrity of the markets is lost. Even in countries that have not reached this point, the available evidence suggests that the impact of money laundering is large enough that macroeconomic policy makers must take it into account. Money subject to laundering behaves in

accordance with particular management principles
(Bartlett: 2000)

There is evidence (Ali: 1998) that it is less productive, and therefore that it contributes minimally, to say the least, to optimization of economic growth. Potential macroeconomic consequences of money laundering include, but are not limited to:

- inexplicable changes in money demand,
- greater prudential risks to bank soundness,
- contamination effects on legal financial transactions,
- and greater volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers.

One cannot only emphasize the economic costs, but also the social and political dimensions of crime and related money laundering—the suffering of the victims and the overall weakening of the social fabric and collective ethical standards. There have been a few detailed studies to measure the extent and economic impact of money laundering. Consequently, the major findings of the studies are reproduced in this chapter.

The negative economic effects of money laundering on economic development are difficult to quantify, yet it is clear that such activity damages the financial-sector institutions that are critical to economic growth, reduces productivity in the economy's real sector by diverting resources and encouraging crime and corruption, which slows economic growth, and can distort the economy's external sector; international trade and capital flows, to the detriment of long-term economic development (Jordan: 1999).

Effective anti-money-laundering policies, on the other hand, reinforce a variety of other good-governance policies that help sustain economic development, particularly through the strengthening of the financial sector.

A study by (Quirk: 1996) analyzed three specific areas of the economy that are impacted namely; the financial sector, the real sector and the external sector. These findings are briefly summarized below.

The financial sector

A broad range of recent economic analyses points to the conclusion that strong developing-country financial institutions such as banks, insurance companies and

equity markets are critical to economic growth. Such institutions allow for

- the concentration of capital resources from domestic savings and perhaps even funds from abroad and
- the efficient allocation of such resources to investment projects that generate sustained economic development.

Money laundering impairs the development of these important financial institutions for two reasons.

First, money laundering erodes financial institutions themselves. Within these institutions, there is often a correlation between money laundering and fraudulent activities undertaken by employees. At higher volumes of money-laundering activity, entire financial institutions in developing countries are vulnerable to corruption by criminal elements seeking to gain further influence over their money-laundering channels.

Second, particularly in developing countries, customer trust is fundamental to the growth of sound financial institutions, and the perceived risk to depositors and investors from institutional fraud and corruption is an obstacle to such trust (Quirk: 1999).

By contrast, beyond protecting such institutions from the negative effects of money laundering itself, the adoption of anti-money-laundering policies by government and regulators, as well as by banks, reinforce the other

good-governance practices that are important to the development of these economically critical institutions (Quirk: 1999).

The real sector

Aside from money laundering's negative effect on economic growth through its erosion of developing countries' financial sectors, money laundering has a more direct negative effect on economic growth in the real sector by diverting resources to less-productive activity, and by facilitating domestic corruption and crime, which in turn depress economic growth (Quirk: 1999)

As can be seen from our earlier discussion in chapter 2, money laundered through channels other than financial institutions is often placed in what are known as "sterile" investments, or investments that generate little additional productivity for the broader economy, such as real estate, art, antiques, jewelry, and luxury automobiles. For developing countries, the diversion of such scarce resources to less-productive domestic assets or luxury imports is a serious detriment to economic growth. Moreover, criminal organizations can transform productive enterprises into sterile investments by operating them for the purposes of laundering illicit

proceeds rather than as profit-maximizing enterprises responsive to consumer demand and worthy of legitimate investment capital.

Money laundering also facilitates crime and corruption within developing economies, which negates sustainable economic growth. Just as an efficient financial sector is a key "input" to other productive processes in a developing economy—such as manufacturing—an efficient money-laundering channel is a key "input" to crime because the financial proceeds from crime are less valuable to the criminal (in a sense, an "unfinished product") than are laundered funds. The less expensive the money laundering "input" to crime is as a result of lax anti-money-laundering policies, the more "productive" (active) the criminal element will be, just as in any industry or business. As numerous studies have demonstrated from statistical and anecdotal evidence, substantial crime and corruption act as a brake on economic development, while other studies have shown that anti-money-laundering policies can deter such activity (Quirk: 1999).

The external sector

Unabated money laundering can also impair a developing country's economy through the country's trade and international capital flows. The well recognized problem

of illicit capital flight from developing countries is typically facilitated by either domestic financial institutions or by foreign financial institutions ranging from offshore financial centers to major money-center institutions such as those in New York, London, or Tokyo. Given that illicit capital flight drains scarce resources from developing economies, transnational money-laundering activity helps impair developing-country growth. By contrast, there is little evidence that the imposition of anti-money-laundering policies in a given jurisdiction spurs a significant flight of capital to more lax jurisdictions.

Moreover, just as the confidence that developing-country citizens have in their own domestic financial institutions is critical to economic growth, the confidence that foreign investors and foreign financial institutions have in a developing country's financial institutions is also important for developing economies because of the role such confidence plays in investment decisions and capital flows.

Money laundering can also be associated with significant distortions to a country's imports and exports. On the import side, criminal elements often use illicit proceeds to purchase imported luxury goods, either with laundered

funds or as part of the process of laundering such funds. Such imports do not generate domestic economic activity or employment, and in some cases can artificially depress domestic prices, thus reducing the profitability of domestic enterprises.

Moreover, International Monetary Fund studies suggest that smaller countries can become favored by large-scale money launderers for short periods of time, causing a sharp surge in financial activity, followed by an equally sharp decline, resulting in severe macroeconomic instability as local authorities are unable to take offsetting monetary or exchange-rate measures.

5.2 Implications for a countries political system

Money laundering trends have also increased the vulnerability of politicians or government officials to the dangers of money laundering. The criminal proceeds laundered through businesses are far more corrosive of local political structures than they are when transiting the international banking community in the form of cash in suitcases (Naylor: 1987).

Inevitably money laundering on any scale will undermine the financial structure and the judicial process, buy

political protection and will neutralize any local or international law enforcement effort. Small islands and territories in particular slip easily under the control of criminal elements, usually fronted by rich and apparently successful local businessmen who exercise a degree of political influence through their contribution to the political parties. Increasingly in a country, political influence is determined by the funds available as old political dogma tends to become irrelevant as the costs of political campaigns rise (Rose-Ackerman: 1999)

5.3 Implications for economic development

Launderers are continuously looking for new routes for laundering their funds. Economies with growing or developing financial centers, but inadequate controls are particularly vulnerable as established financial center countries implement comprehensive anti-money laundering regimes. Launderers, who tend to move their networks to countries and financial systems with weak or ineffective countermeasures, will exploit differences between national anti-money laundering systems. Some might argue that developing economies cannot afford to be too selective about the sources of capital they attract. But postponing action is obviously dangerous. The more it is deferred, the more entrenched organized crime can become.

As with the damaged integrity of an individual financial institution, there is a damping effect on foreign direct investment when a country's commercial and financial sectors are perceived to be subject to the control and influence of organized crime (Bartlett: 2000).

5.4 Implications for society at large

The possible social and political costs of money laundering, if left unchecked or dealt with ineffectively, are serious. Organized crime can infiltrate financial institutions, acquire control of large sectors of the economy through investment, or offer bribes to public officials and indeed governments. The economic and political influence of criminal organizations can weaken the social fabric, collective ethical standards, and ultimately the democratic institutions of society (Nardo: 1998). In countries transitioning to democratic systems, this criminal influence can undermine the transition. Most fundamentally, money laundering is inextricably linked to the underlying criminal activity that generated it. Laundering enables criminal activity to continue.

Chapter 6

Money Laundering in South African context

6.1 South Africa's Money laundering legislation

Since 1992, the South African Reserve Bank has been in negotiations with the International Monetary Fund (IMF), the United States Federal Reserve Bank and many European financial institutions to ensure that South Africa can compete on the international stage with sophisticated and stable money markets (Itzikowitz: 1998).

To comply with international banking standards, South Africa has promulgated various anti money laundering laws, including:

- Drugs and Drug Trafficking Act (1992)
- Proceeds of Crime Act (1996).
- Prevention of Organized Crime Act (1998).
- Financial Intelligence Centre Act (2001).

All these laws have been designed to make South Africa compliant with anti-money laundering legislation and to assist with the tracking and tracing of money worldwide. Unfortunately, the effectiveness of these laws has yet to be tested. Meanwhile, the threats of money laundering and

terrorist financing remain unchallenged and more stringent methods are required.

The Financial Intelligence Centre Act and the establishment of the Centre are based on Government's understanding of the longstanding, global effort to combat organized crime and money laundering. In doing so, Government's priority has been to ensure the sound health of the country's financial system by preventing it from being contaminated and undermined by funds and hot money flowing as proceeds from crime. It has simultaneously created a tool for law enforcement to minimize money laundering and reduce organized criminal activities. Money laundering is a problem for which the solution is to ensure not only national action, but also international co-operation. During the 1980s many countries recognised that individual countries working in isolation would not find the solution to the money-laundering problem. Instead, international cooperation was a prerequisite for success.

South Africa enacted the Drugs and Drug Trafficking Act in 1992, which first introduced a money laundering offence on the statute book and which was followed by the Proceeds of Crime Act (PCA) of 1996. The PCA introduced a broader range of offences and criminalized money

laundering for the first time. In 1999, the Proceeds of Crime Act, as well as the laundering provisions of the Drugs and Drug Trafficking Act, were repealed when the Prevention of Organized Crime Act (POCA) came into effect (De Koker: 1999).

This act had the effect of:

1. criminalizing racketeering and creating offences relating to activities of criminal gangs;
2. criminalizing money laundering in general and also creating a number of serious offences in respect of laundering and racketeering;
3. contains a general reporting obligation for businesses coming into possession of suspicious property; and
4. contains mechanisms for criminal confiscation of the proceeds of crime and for civil forfeiture of the proceeds and instrumentalities of offences.

POCA creates two sets of money laundering offences

1. offences involving proceeds of all forms of crime; and
2. offences involving proceeds of a pattern of racketeering.

The Financial Intelligence Centre Act of 2001 was introduced to complement the Prevention of Organized Crime Act. The provisions of FICA came into effect in February 2002. The next chapter discusses this new legislation, which is a main focus of this study.

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6.2 International acceptance of SA's progress

South Africa satisfied the major Financial Action Task Force (FATF) Recommendations with the introduction of FICA. The FATF has developed a set of Recommendations, which set out the principles of the body and act as a global standard for the combating of money laundering and the financing of terrorism (Van Zyl: 1997). However in terms of these 40 Recommendations, South Africa is required to become a member of the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG). The ESAAMLG was established in November 1999 as the regional body of the FATF. The present members are Republics of Kenya, Malawi, Mauritius, Mozambique, Namibia, Seychelles, Uganda, the United Republic of Tanzania, and recently by the Kingdom of Swaziland. Finance Minister Trevor Manuel highlighted the importance of South Africa's acceptance internationally

"Cabinet approval has been granted for South Africa to take its rightful place as a member of ESAAMLG, and our

membership is important for South Africa for a number of related reasons:

- Government has demonstrated that it is committed to combat organized crime and money laundering by passing the Prevention of Organized Crime Act, 1998 and the Financial Intelligence Centre Act, 2001. However, for South Africa to become fully compliant with the FATF requirements and to thereby gain international acceptance for its anti-money laundering stance it needs to become a member of the ESAAMLG. Membership of regional bodies, such as ESAAMLG, is a requirement for membership of FATF, should South Africa wish to take up such membership.
- Already South African business in the financial sector is increasingly faced with questions from international counterparts regarding the South Africa's anti-money laundering stance and its membership of regional anti-money laundering bodies. It is anticipated that this pressure will grow in the period going forward.
- Membership will also obviate pressure to place South Africa on the FATF list of Non-Cooperating Countries and Territories (NCCT), thereby effectively blacklisting the country.

- The problem of money laundering cannot be dealt with in isolation by one country because of the ease with which money is able to flow across borders and requires coordination and mutual support between neighboring countries. This will further strengthen South Africa's anti-money laundering mechanisms.
- Membership of the ESAAMLG will give the FIC easier access to other financial intelligence units on a continuous basis, thereby enabling it to share information and expertise"

The South African Financial Intelligence Centre was accepted as a member by the Egmont Group, a global forum for financial intelligence units, at its annual meeting held in Sydney, Australia in June 2003. By succeeding in its application to join the Egmont Group, the FIC thereby joined an international community with a growing membership of 94 Financial Intelligence Units (FIU) from different countries." South African Minister of Finance Trevor Manuel

6.3 Money laundering trends specific to South Africa

In March 2002 Rand Afrikaans University's (RAU's) Centre for the Study of Economic Crime released a report on

laundering trends. This report was based on the perceptions of a group of expert investigators of economic crime who attended a workshop on money laundering trends at RAU in December 2001. The following is a summary of the broad themes identified in the report: (Centre for the Study of Economic Crime (RAU): 2001)

- purchase of goods and properties;
- abuse of businesses and business entities;
- use of cash and currency;
- abuse of financial institutions;
- abuse of the informal sector of the economy; and
- use of professional assistance.

Purchase of goods and properties

South African criminals often display their illegally acquired wealth. Money is spent on expensive clothes, personal effects, vehicles, property and furniture. In coastal areas boats, some criminals also purchase jet skis and yachts and in rural areas livestock and farm implements are bought. According to the report these purchases are not necessarily made with the intention to launder money. In the majority of cases criminals merely want to enjoy the proceeds of their crimes and improve their lifestyles. However, in view of the broad

definition of laundering in South African law, such transactions would still constitute laundering offences under POCA. Vehicles and real estate are often registered in the names of the criminals, but sophisticated criminals who are concerned about the risks of confiscation and forfeiture of their assets ensure that these assets are registered in the name of a front company, a family member or a close friend. These criminals would often register real estate in the name of a family trust or business trust, which is ultimately controlled by the criminal. Real estate transactions are also abused in another way to launder money: Proceeds of crime are paid into the trust account of an attorney or an estate agent by a new client who instructs the attorney or agent to assist him in acquiring a property. A few days later the client cancels the instructions and requests the repayment of the money. The money is often repaid by means of a cheque drawn by the attorney or the estate agent. In these cases the criminal uses the scam of a transaction to launder a sizable amount of money through the trust account of the attorney or estate agent. Although vehicles are often bought for cash and real estate transactions are sometimes settled in cash, cases have also been encountered where the criminal obtained financing for the transaction from a financial institution. The proceeds of crime are then used to

settle the hire purchase obligations or to pay off the bond in a short period. In certain cases, the payments continue after all the obligations to the financial institution were met. As a result a surplus amount builds up in the particular account. Such amounts can escape detection by law enforcement authorities.

Abuse of businesses and business entities

Criminals often use business activities and business enterprises to launder money. Such business activities are conducted in the formal and informal sectors of the South African economy. These business enterprises can be unincorporated (for instance sole proprietorships, business trusts and partnerships) or incorporated (for instance close corporations and companies). Shell corporations are sometimes used to open and operate bank accounts. These entities will not actually be trading and their main purposes would be to provide the criminal with a corporate cloak under which he could hide his identity and launder money. The shareholders, directors or members of these shell corporations are often family members or other third parties who will act according to the instructions of the ultimate controller of the corporation. The corporations could be registered personally or through an agent, such as an auditor or attorney, or be bought as pre-registered (so-called shelf

companies). Shelf companies are advertised for as little as R650 and close corporations for only R450.

Front businesses often feature in laundering schemes. Unlike shell corporations, these businesses are trading actively. The proceeds of crime are used to fund the business activities of the enterprise and/or are simply co-mingled with the legitimate proceeds of the business itself and deposited into the bank account of the business as the proceeds of the business. If the criminal launders cash, the front business will normally be cash-based to facilitate the process. Examples of such businesses that have been encountered in South Africa include bars, restaurants, shebeens, cash loans businesses and cell phone shops.

Use of cash and currency

Criminals who commit offences that generate cash proceeds, for instance cash heists or drug trafficking, are often able to transfer or spend substantial amounts without using the formal financial system. There are indications that substantial amounts are transferred physically to and from destinations in South Africa, whether by the criminals themselves or by third parties who act as couriers. Cash can be transferred physically in many ways, but during the RAU workshop specific

examples were cited where cash was strapped to bodies of passengers in motor vehicles and aircraft or hidden in their luggage. Similar methods are used to convey cash across the borders of South Africa. While it is legitimate to convey cash physically within South African borders, substantial cash amounts can only be transferred across South Africa's borders legally if the exchange control requirements have been met.

Criminals launder illicit cash in many ways. As outlined earlier, luxury goods, vehicles and real estate may be bought. Trust accounts of professionals such as attorneys and estate agents are sometimes used to place the cash amounts in the financial system. Automatic teller machines and automatic vending machines selling cell phone products have also been used to place cash amounts. Laundering of cash also takes place in legal as well as illegal gambling institutions. In these cases, criminals or their assistants would often buy gambling chips or credits in cash. After a short period of gambling, the gambler would return and exchange the chips or credits for a cheque issued by the gaming institution. Slot machines in casinos have also proved vulnerable for abuse by launderers who used them successfully to launder bank notes that were stained by dye during cash heists. There is also evidence of laundering of cash at racecourses in

South Africa. In some instances, the launderer would buy a winning ticket from a punter for a cash amount, which constitutes a premium on seller's actual winnings.

Abuse of financial institutions

South Africa has a well-developed financial system. Products on offer vary from Internet banking facilities and offshore unit trust investments to small savings accounts for a target audience comprising people who have not previously had a bank account or are under-banked. Exchange controls have deterred the large-scale abuse of the financial system by international launderers.

However, South African criminals are abusing the system in many different ways to launder and invest their ill-gotten gains. According to the report, a sizable amount of dirty money is still deposited into bank accounts. Criminals sometimes deposit money into their own bank accounts, but more sophisticated criminals often open accounts with false identification documentation or open these in the names of front companies or trusts.

There is also a trend of using legitimate bank accounts of family members or third parties. An arrangement is made with a family member who allows the criminal to deposit and withdraw money from his or her account. In subsequent investigations, the family member invariably

pleads ignorance of the true nature of the funds that were deposited. The first two convictions that were handed down for statutory money laundering in South Africa were based on such arrangements. There is also evidence that more sophisticated criminals are using credit and debit card facilities to launder money and especially to move proceeds of crime across the borders of South Africa. Automatic teller machines are also used to deposit and withdraw money. Automatic teller machines that offer the facility to generate bank cheques have featured in particular laundering schemes. Bearer documents such as Negotiable Certificates of Deposit have also been employed in sophisticated schemes.

During the RAU workshop cases were also cited of insurance products being used to launder money. Single premium policies are bought with the proceeds of crime or the proceeds are used to pay monthly premiums. In some cases, the launderer makes an overpayment and then asks for a repayment of the excess amount. When the company repays the excess amount, the launderer represents the money as a payment in terms of an insurance product. In other cases, the launderer buys and surrenders policies. There is a substantial market in second-hand policies in South Africa and this market is also vulnerable to abuse by launderers.

Abuse of the informal sector of the economy

The prevalence of informal business enterprises in South Africa, coupled with the general absence of formal financial and other business records, allow for the abuse of such enterprises by launderers. They serve as convenient front businesses because it is difficult to dispute the business's alleged turnover in relation to its actual turnover. In fact, it is often impractical for formal sector businesses to attempt to verify business information furnished to them by informal sector businesses.

Sizable amounts of cash are also deposited into community-based rotating credit schemes that operate general savings schemes (for instance stokvels), or dedicated savings schemes (for instance burial societies). In the majority of these cases, all the members are known to one another. Every member regularly deposits an agreed sum of money into a fund that is given, in whole or in part, to each member in rotation. Although a launderer cannot penetrate the majority of schemes, a launderer could operate a sham stokvel as a front to launder money.

Underground banking systems in the form of hawala/hundi systems are operating in South Africa within specific

ethnic communities. These systems have apparently been used for many years to evade exchange control restrictions and expensive foreign exchange transaction fees. There are a number of other organizations, which operate on the outer fringes of the regulatory systems that are also vulnerable to abuse as front businesses by launderers. These include NGOs, charitable institutions and churches.

The abuse of the informal sector by launderers is a cause for concern. The laundering laws primarily regulate the formal sector of the economy. The extent of laundering in the informal economy cannot be estimated with any degree of certainty, but it is probably substantial. Arguments that laundered proceeds in the informal economy will be detected at the stage when such funds enter the formal sector of the economy do not sufficiently discount the nature of the informal sector of the economy. Proceeds can be placed, layered and integrated in the informal sector without entering the formal sector of the economy. If a launderer requires the proceeds to enter the formal sector, he can ensure that they do so at a stage when they have been laundered sufficiently and cannot be linked to unlawful activity any more.

Professional assistance

Many laundering schemes are too complicated to be planned and executed by the criminals themselves. There is clear evidence that knowledgeable persons do assist criminals to launder money. These persons often have legal, banking or tax expertise or general business acumen. For example, in the first case in which a conviction was handed down for statutory money laundering, *State v Dustigar*, an attorney and a police officer played key roles in planning and operating different laundering schemes.

Chapter 7

The Financial Intelligence Centre Act

The Financial Intelligence Centre Act 38 of 2001 (FICA)

The origins of FICA can be traced back to August 1996 when the South African Law Commission published a Money Laundering Control Bill as part of a report entitled Money laundering and related matters (Smit: 1999). The Bill provided for regulatory structures and mechanisms to combat money laundering. However, the government did not take immediate action on the legislation. In 1998, the Department of Finance appointed a task team to advise it on the appropriateness of the Bill. The Department of Finance produced a new Financial Intelligence Centre Bill based on the recommendations of the Task Team. Further consultation, especially with other government departments, took place before the Bill was finally approved by Cabinet and submitted to parliament in 2001.

After much deliberation, public comment and extensive amendment the legislation was passed and the President signed it on 28 November 2001. However, its provisions only came into effect on 1 June 2003 as determined by the President by proclamation. The Act which is therefore

relatively new to South Africans and being a focal point of this study requires a summary to place into perspective the following chapters of this study. As such, an attempt is made to set out the main components relevant to this study. This is merely a summary of the Act and it is not a substitute for the legislation itself. The actual Act comprises 5 chapters over 80 pages long.

7.1 Summary of the ACT

CHAPTER 1 - FINANCIAL INTELLIGENCE CENTRE (FIC) SECTIONS 2 - 16

Chapter one of the Act establishes the Financial Intelligence Centre, whose main objectives are to identify the proceeds of unlawful activities and to combat money-laundering activities. The FIC will be involved mainly in the processing, analyzing and interpretation of information disclosed to it and obtained by it. It will however also monitor and give guidance to accountable institutions (see annexure 1) and supervisory bodies regarding their duties under and in compliance with the Act.

CHAPTER 2 - MONEY LAUNDERING ADVISORY COUNCIL (MLAC)
SECTIONS 17 - 20

This chapter establishes the Money Laundering Advisory Council MLAC, which consists of representatives of accountable institutions, supervisory bodies and organs of state approved by the Minister. MLAC's function is to advise the Minister on policies and best practices in order to identify the proceeds of unlawful activities, and to combat money laundering activities, as well as to advise the FIC concerning the performance by the FIC of its functions. MLAC also acts as a forum for the various representatives in which they can consult one another.

CHAPTER 3 - MONEY LAUNDERING CONTROL MEASURES
SECTIONS 21 - 45

Section 21 - Identification of clients and other persons
An accountable institution may not establish a business relationship, or conclude a single transaction, with a client unless it has taken the prescribed steps to establish and verify the identity of the client, any person who is acting on behalf of a client and any person on whose behalf the client may be acting.

Section 22 - Record to be kept of business relationships and transactions

All documentation used to identify and verify clients and client accounts must be kept. A record must also be kept of the name of the person who obtained the client identification and verification documents. Records must also be kept of all transactions, identifying the amounts and parties involved.

Section 23 - Period for which records must be kept

The relevant records must be kept for at least 5 years from the date on which a business relationship is terminated or, if there is no business relationship, from the date on which a single transaction is concluded.

Section 24 - third parties may keep Records

If a third party keeps the relevant records, their details must be provided to the FIC. The accountable institution must have free and easy access to the records. Any failure by the third party to comply properly with the requirements of section 22 will result in the accountable institution being held liable. You cannot simply rely on the third party.

Section 25 - Admissibility of records

Certified extracts of records and certified printouts of electronic records are, on their mere production before a

court, admissible as evidence of any fact contained in them of which direct oral evidence would be admissible.

Section 26 - FIC's access to records

An authorized representative of the FIC is entitled to have access during working hours to all records kept by an accountable institution in terms of section 22 and section 24. However, unless the records are those that the public is entitled to have access to, the authorized representative may only exercise these powers by virtue of a warrant issued in chambers by a magistrate, regional magistrate or judge. An accountable institution must, without delay, give an authorised representative of the Centre all reasonable assistance.

Section 27 - Accountable institutions to advise FIC of clients.

If an authorized representative of the FIC requests an accountable institution to advise whether a specified person is or has been a client, either directly or indirectly of the institution, they must inform the FIC accordingly.

Section 28 - Cash transactions above prescribed limit

Cash paid to or received from a client must be reported within a prescribed period. There are, however, no

regulations in relation to this section yet so the prescribed limit has not yet been set.

Section 29 - Suspicious and unusual transactions

Any person who carries on a business, is in charge of or manages a business or who is employed by a business and who knows or suspects:

- that the business has received or is about to receive the proceeds of unlawful activities; or
- that one or more transactions by that business with a third person will facilitate the transfer of proceeds of unlawful activities;
- that a transaction with a third person has no apparent lawful or business purpose; or
- that a transaction is being conducted by a third person to avoid being reported under this Act; or
- that the transaction or series of transactions may be relevant to the investigation of an evasion or attempted evasion of a duty to pay any tax, duty or levy imposed by legislation administered by the Commissioner for the South African Revenue Service; or
- that the business has been used or is about to be used for money laundering purposes must report this to the FIC within the prescribed period. This period

is as soon as possible, but not later than 15 business days. It is important to note that the person making the report may not disclose to any other person the fact that he or she has made the report, and no person who knows or suspects that a report is or will be made may disclose this fact to any other person.

Section 30 - Conveyance of cash to or from Republic

Any person intending to convey cash to or from the Republic that exceeds a prescribed amount will have to report this to a person authorized by the Minister for this purpose. Again, there are no regulations in relation to this section yet, so the prescribed amount has not yet been set.

Section 31 - Electronic transfers of money to or from the Republic

Money received from outside of RSA or sent to a country outside of RSA that is over a prescribed amount must be reported to the FIC. The FIC will be entitled to request prescribed particulars. Again, there are no regulations and therefore no prescribed amount in relation to this section yet.

Section 32 - Reporting procedures and furnishing of additional information

Reports as required under sections 28, 29, 30 & 31 must be made in the format prescribed by the FIC. Only the FIC, an investigating authority acting with the permission of the FIC or an authorized officer may request information over and above that contained in the original report made to the FIC. This information is to be furnished without delay.

Section 33 - Continuation of transactions

A transaction in respect of which a report is required to be made may be continued with unless the FIC directs otherwise.

Section 34 - Intervention by Centre

The FIC may direct an accountable institution, reporting institution or a person making a report in terms of section 28 and section 29, in writing, not to proceed with a transaction or proposed transaction or any other transaction in respect of the funds affected by that transaction. The transaction can only be "frozen" for a total of 5 days (not taking into account weekends and public holidays) while the FIC makes the necessary enquiries and, if it deems

appropriate, inform and advise an investigating authority or the National Director of Public Prosecutions.

Section 35 - Monitoring orders

A designated judge may, on receipt of a written application from the FIC, order an accountable institution to report to the FIC on all transactions concluded by a specified person or account. The order will be granted if there are reasonable grounds to suspect that funds transferred to or received by the accountable institution are the proceeds of unlawful activities, or that the account is being used to launder money. This order lapses after 3 months but may be extended, at the discretion of the judge, if the reasonable grounds for the suspicion still exist or the judge deems that the interests of justice will best be served by continued monitoring.

Section 36 - Information held by supervisory bodies and SARS

If a supervisory body or SARS knows or suspects that an accountable institution is being used or is about to be used for money laundering purposes, or that the institution has wittingly or unwittingly received or is about to receive the proceeds of unlawful activities, it must inform the FIC of the facts and provide the FIC with

any documentation or information that it may possess. If the FIC believes that a supervisory body or SARS has information in this regard, the FIC may request the supervisory body or SARS to furnish it with all information and any records regarding that accountable institution. The supervisory body and SARS may make such reasonable procedural arrangements, and impose such reasonable safeguards regarding the furnishing of such information as they consider appropriate to maintain the confidentiality of that information.

Section 37 - Reporting duty and obligations to provide information not affected by confidentiality rules

No duty of secrecy or confidentiality or any other restriction on the disclosure of information, whether imposed by legislation or arising from the common law or agreement, affects compliance with this Act. The only exception applies to the common law right to legal professional privilege between an attorney and his/her client.

Section 38 - Protection of persons making reports

No action, whether criminal or civil, may be brought against anyone who complies in good faith with a provision of this Part of the Act. A person who has made, initiated or contributed to a report in terms of S28, S29

or S31 is competent but not compellable to give evidence in criminal proceedings. No evidence concerning the identity of these persons is admissible as evidence in criminal proceedings unless that person testifies at those proceedings.

Section 39 - Admissibility as evidence of reports made to Centre

A certificate issued by an official of the FIC that information specified in the certificate was reported or sent to the FIC on its mere production in a matter before a court admissible as evidence of any fact contained in it of which direct oral evidence would be admissible.

Section 40 - Access to information held by the Centre

No person is entitled to information held by the FIC, except:

- an investigating authority inside the Republic, the SARS and the intelligence services, on the written authority of an authorised officer or at the initiative of the FIC if either of these parties believes such information is required to investigate suspected unlawful activity;
- an entity outside the Republic performing similar functions to those of the FIC, or an investigating authority outside the Republic, if the FIC believes

the information is relevant to the identification of the proceeds of unlawful activities or the combating of money laundering in that particular country;

- an accountable institution or reporting institution or any other person who may, at the initiative of the FIC, be provided with information regarding the steps taken by the FIC in connection with transactions reported by that party, subject to certain conditions. If the FIC reasonably believes that disclosure to an accountable institution, reporting institution or other person of information requested could inhibit the achievement of the objectives of the FIC or another organ of state or the performance of their functions, or prejudice the rights of any person, it will not provide the information requested. The FIC will also provide information if this is requested in terms of an order of a court or in terms of other national legislation.

Section 41 - Protection of confidential information

No person may disclose confidential information held by or obtained from the FIC, except -

- within the scope of that person's powers and duties in terms of any legislation;

- for the purpose of carrying out the provisions of this Act;
- with the permission of the Centre;
- for the purpose of legal proceedings, including any proceedings before a judge in chambers; or
- in terms of an order of court.

Section 42 - Formulation and implementation of internal rules

An accountable institution must formulate and implement internal rules concerning-

- establishment and verification of identity of clients;
- the information on which records must be kept and how and where the information must be stored;
- steps to be taken to determine whether a transaction is reportable; and
- such other matters as may be prescribed.

The internal rules must comply with the requirements prescribed in the regulations, and must be made available to all employees involved in transactions to which the Act applies, as well as on request to the FIC or appropriate supervisory body.

Section 43 - Training and monitoring of compliance

An accountable institution must:

- provide training to its employees to enable them to comply with the Act and the internal rules;
- appoint a person with the responsibility to ensure compliance by
 - the employees of the institution; and
 - the institution itself with the Act and the internal rules.

Section 44 - Referral of suspected offences to investigating authorities and other public bodies

If the FIC has reasonable grounds to suspect that an accountable institution, or any other person other than a supervisory body, has contravened or failed to comply with the Act, the FIC may refer the matter to a relevant investigating authority, an appropriate supervisory body or other public body or authority affected by it. The FIC may make any recommendation it considers appropriate in this regard.

Section 45 -Responsibility for supervision of accountable institution

Each supervisory body is responsible for supervising compliance with the provisions of Chapter 3 by each accountable institution regulated or supervised by it. If

the FIC refers a matter to a supervisory body, they must investigate it and take whatever steps are in their power to remedy the matter. Should they fail to do this, the FIC may take such steps within the scope of its powers to remedy the matter.

CHAPTER 4 - OFFENCES AND PENALTIES

SECTIONS 46 - 71

Section 68 - Penalties

1) A person convicted of an offence mentioned in this Chapter, other than an offence mentioned in subsection (2), is liable to imprisonment for a period not exceeding 15 years or to a fine not exceeding R10 million.

2) A person convicted of an offence mentioned in section 55 (failure to send report), 61 (failure to formulate and implement internal rules) or 62 (failure to provide training or appoint a compliance officer) is liable to imprisonment for a period not exceeding five years or to a fine not exceeding R1 million.

Section 69 - Defences

If a person who is an employee, director or trustee of, or a partner in, an accountable institution is charged with committing an offence under section 52 (failure to report suspicious or unusual transactions), that person may raise as a defence the fact that he or she had-

- (a) complied with the applicable obligations in terms of the internal rules relating to the reporting of information of the accountable institution; or
- (b) reported the matter to the person charged with the responsibility of ensuring compliance by the accountable institution with its duties under this Act; or
- (c) reported the matter to his or her superior, if any, if-
 - (i) the accountable institution had not appointed such a person or established such rules; or
 - (ii) the accountable institution had not complied with its obligations in section 42(3) in respect of that person; or
 - (iii) the internal rules were not applicable to that person.

Section 70 - Search, seizure and forfeiture

This section is concerned with seizure and forfeiture of cash contemplated in section 30 and in connection with the suspected commission of an offence under section 54 in respect of that cash or any portion of it. Whenever a person is convicted of an offence under section 54 or 64 the court convicting that person must, in addition to any punishment which that court may impose in respect of the

offence, declare any property in respect of which those transactions were conducted to be forfeited to the State.

Section 71 - Jurisdiction of courts

- 1) A regional court has jurisdiction to impose any penalty mentioned in section 68(1), even though that penalty may exceed the penal jurisdiction of that court.
- 2) A magistrate's court has jurisdiction to impose any penalty mentioned in section 68(2), even though that penalty may exceed the penal jurisdiction of that court.
- 3) A magistrate's court or regional court has jurisdiction to make any order of forfeiture referred to in section 70, even though the amount forfeitable under that order may exceed the civil jurisdiction of the magistrate's court or regional court.

CHAPTER 5 - MISCELLANEOUS SECTIONS 72 - 82

Section 72 - Act not to limit powers of investigating authorities or supervisory bodies

This Act does not detract from—

- (a) an investigating authority's powers in terms of other legislation to obtain information for the purpose of criminal investigations; or
- (b) a supervisory body's duties or powers in relation to the entities supervised or regulated by it.

Section 73 - Amendment of list of accountable institutions

The Minister may, by notice in the Gazette, amend the list of accountable institutions in Schedule 1 to add to the list any person or category of persons, delete any institution or category of institutions from the list or make technical changes to the list. Before the Minister amends Schedule 1, the Minister must consult MLAC and the FIC. Any addition to or deletion from the list of accountable institutions in Schedule 1 must, before publication in the Gazette, be approved by Parliament.

Section 74 - Exemptions for accountable institutions

The Minister may, after consulting MLAC and the FIC, and on conditions and for a period determined by the Minister, exempt from compliance with any of the provisions of this Act a person, an accountable institution, or a category of persons or accountable institutions. He may also exempt from any or all of the

provisions of this Act, a person or category of persons or an accountable institution or category of accountable institutions in respect of any one or more categories of transactions. Any exemption referred to must be by notice in the Gazette and may be withdrawn or amended by the Minister, after consulting with MLAC and the FIC and must be tabled in Parliament before being published in the Gazette.

Section 76 - Amendment of list of reporting institutions

The Minister may, by notice in the Gazette, amend the list of reporting institutions in Schedule 3 to add, delete or make technical changes to the list. Before the Minister amends Schedule 3, the Minister must consult the FIC and MLAC, and-

- (a) if only one person will be affected by the proposed amendment, give the person at least 30 days' written notice to submit written representations to the Minister; or
- (b) if a category of persons will be affected by the proposed amendment, by notice in the Gazette give persons belonging to that category at least 60 days' written notice to submit written representations to the Minister. Any addition to or deletion from the list of reporting institutions in

Schedule 3 must, before publication in the Gazette, be approved by Parliament.

Section 77 - Regulations

- (1) The Minister, after consulting MLAC and the FIC, may make, repeal and amend regulations concerning— (a) any matter that may be prescribed in terms of this Act; and (b) any other matter which is necessary or expedient to prescribe or to promote the objectives of this Act.
- (2) Regulations may— (a) differ for different accountable institutions, reporting institutions, persons, categories of accountable institutions, reporting institutions and persons and different categories of transactions; (b) be limited to a particular accountable institution or reporting institution or person or category of accountable institutions or reporting institutions or persons or a particular category of transactions; and (c) for a contravention of or failure to comply with any specific regulation, prescribe imprisonment for a period not exceeding six months or a fine not exceeding R100 000.

(3) Regulations in terms of subsection (1) must be reviewed by MLAC within two years after being published in the Gazette and thereafter at such intervals as MLAC deems appropriate.

(4) The Minister must table regulations, repeals and amendments made under subsection (1) in Parliament before publication in the Gazette.

Section 78 - Indemnity

The Minister, the FIC or an employee or representative of the FIC, or any other person performing a function or exercising a power in terms of this Act, is not liable for anything done in good faith in terms of or in furthering the objectives of this Act.

7.2 The Financial Intelligence Centre

7.2.1 Its place between Business and Government

The Financial Intelligence Centre is constituted as a juristic person located outside the public service, but within the public administration in terms of section 195 of the Constitution. It is accountable through the Minister of Finance to Parliament and is funded mainly from the national budget. The Centre functions as an independent agency alongside the investigating authorities providing them with information gleaned from

reports made to it by accountable institutions. The authorities include the:

- South African Police Services;
- Directorate of Special Operations (Scorpions);
- Asset Forfeiture Unit;
- South African Revenue Service;
- Intelligence Services; and the
- Exchange Control department of the South African Reserve Bank.

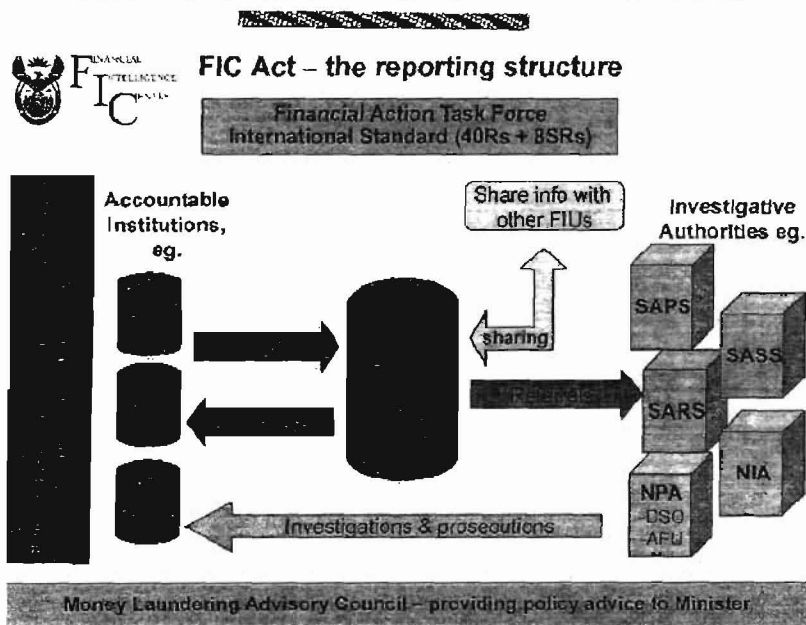
The Centre has also sought to develop its relationship with the various supervisory bodies, which are listed in Schedule 2 of the Act (listed below). The purpose is to facilitate them being able to fulfil their responsibilities as set out in the Act. The Act requires these bodies to ensure that the accountable institutions falling within their area of oversight function is in full compliance with the legislation. The supervisory bodies designated in the Act are:

- The Financial Services Board
- The South African Reserve Bank
- The Registrar of Companies
- The Estate Agents Board
- The Public Accountants and Auditors Board
- The National Gambling Board

- The JSE Securities Exchange South Africa.
- The Law Society of South Africa.

The concepts and operation discussed above is illustrated below as envisaged by the Financial Intelligence Centre.

FRAMEWORK FOR DEVELOPING THE FINANCIAL INTELLIGENCE CENTRE



Source: Financial Intelligence Centre Website

7.3 The FIC in practice

7.3.1 Overview

The Financial Intelligence Centre Act, 2001, sets up a regulatory anti-money laundering regime, which is intended to break the cycle used by organized criminal groups to benefit from illegitimate profits. By doing this the Act aims to maintain the integrity of the financial system. Apart from the regulatory regime the Act also creates the Financial Intelligence Centre.

The regulatory regime of the Financial Intelligence Centre Act imposes 'know your client', record-keeping and reporting obligations on accountable institutions. It also requires accountable institutions to develop and implement internal rules to facilitate compliance with these obligations.

The Financial Intelligence Centre Act is the result of 5 years of investigation and development. It complements and works with the Prevention of Organized Crime Act, 1998 which contains the substantive money laundering offences.

7.3.2. Objectives

The Financial Intelligence Centre is established in order to identify the proceeds of unlawful activities and to combat money-laundering activities. It aims to do so by

making information collected by it available to investigating authorities (the Police Service, the Scorpions, the Special Investigating Unit and the Asset Forfeiture Unit), the intelligence services and the Revenue Service. The Financial Intelligence Centre will also exchange information with similar bodies in other countries.

7.3.3. Functions

In order to fulfill its objectives the Centre will collect, process, analyze and interpret information reported to it in terms of various statutory reporting obligations. The Centre will then use this information to inform and advise law enforcement authorities, supervisory bodies, the Revenue Service and the intelligence services and to cooperate with these bodies in the performance of their functions. The Centre will also monitor compliance with the Financial Intelligence Centre Act and give guidance to accountable institutions, supervisory bodies and others. The Centre will in the course of the performance of its functions build up a database of information, which it will retain and utilize to support the above-mentioned bodies in the performance of their functions. Finally the Centre will promote the appointment of persons to specialize in measures to detect and counter money laundering.

By performing these functions the Centre will become a repository of information concerning financial transactions. It will also play an important role in co-ordinating policy and efforts to counter money-laundering activities, which form part of a decentralized but integrated anti-money laundering regime (Financial Intelligence Centre Annual Report: 2004).

Chapter 8

Money Laundering and the Fiscus

Of the underlying forms of illegal activity, tax evasion is, perhaps, the one with the most obvious macroeconomic impact. Money laundering makes government's tax collection procedures more difficult and diminishes tax revenue to the fiscus. The resulting loss of untaxed revenue generally means higher tax rates for law-abiding citizens and corporates. The cumulative effect of laundering activities is to destabilise the foundations of a country's financial system (Glover: 1997).

The more open and competitive environment of the last decade has had many positive effects on our tax systems in South Africa, including the reduction of tax rates and broadening of tax bases which have characterized tax reforms over the last 10 years. In part these developments can be seen as a result of global competitive forces, which have encouraged countries to make their tax systems more attractive to investors. In addition to lowering overall tax rates, a competitive environment can promote greater efficiency in government expenditure programs (Financial Intelligence Centre Annual Report: 2004).

However, some tax and related practices are anti-competitive and can undercut the gains that tax competition generates. This can occur when governments introduce practices designed to encourage noncompliance with the tax laws of other countries (for example the practice of so called "tax havens" discussed earlier in chapter 3).

Many countries have put in place measures to prevent the erosion of their tax bases. Such measures often increase the complexity of their tax systems and put greater burdens and costs on tax administrations as well as on compliant taxpayers. Ultimately, taxpayer confidence in the fairness of the tax system, and in government in general, declines as honest taxpayers feel that they shoulder a greater share of the tax burden and that government cannot effectively enforce its own tax laws. Harmful tax practices also distort financial and, indirectly, real investment flows. Furthermore, such practices undermine the ability of each country to decide for itself the allocation of tax burden among mobile and less mobile tax bases, such as labor, property and consumption (Walter: 1990).

8.1 The role of the South African Revenue Services (SARS)

The South Africa Revenue Service, which includes the Customs Service, is responsible for revenue collection and the investigation of tax evasion and evasion of customs duties, and works closely with law enforcement agencies on money laundering matters.

The Financial Intelligence Centre Act (FICA) creates a special relationship between the Financial Intelligence Centre (FIC) and the SARS. The FIC data will assist SARS to combat tax evasion and to collect taxes more effectively. Section 29 of the ACT (suspicious and unusual transactions) explicitly requires all businesses to report any transactions that may be relevant to the investigation of any evasion or attempted evasion of a duty to pay a tax, levy or duty under any legislation that is administered by the SARS. The SARS, in turn, is required by FICA to divulge certain information relating to the possible abuse of an accountable institution for laundering, or its possible involvement therein, to the FIC. However, section 36 (2) of FICA allows the SARS to make reasonable procedural arrangements and to impose reasonable safeguards to maintain the confidentiality of the information that is disclosed in terms of FICA.

The SARS and the Asset Forfeiture Unit of the National Director of Public Prosecutions have also established a capacity to investigate money laundering. Each institution obviously has its own unique focus on laundering: the SARS focuses on money laundering linked to tax evasion and the Asset Forfeiture Unit on the confiscation and forfeiture of proceeds and instrumentalities of crime. However, their investigations will often overlap with investigations into money laundering or will reveal money laundering. Both institutions have therefore been sensitizing their investigators to money laundering and a core group of investigators of SARS has also been trained in money laundering control.

8.2 Potential impact of FICA on the Fiscus

Whilst the new legislation cannot totally eradicate the laundering of undeclared income or the proceeds of tax evasion, the many obligations now placed on accountable institutions (banks, casinos, insurance companies etc) in terms of FICA is most likely to be a further deterrent to tax evasion. Money laundering by its very nature does not lend itself to being accurately measured but based on conservative estimates discussed in chapter 3, this can amount to a substantial loss to the fiscus. The estimated

range of between two and five percent of the worlds GDP would translate to between R24 billion and R60 billion being laundered in South Africa annually. (Based on SA's GDP projection of approximately R1, 2 trillion for 2004 - Department of Finance: 2003) If one applies the minimum marginal tax rate of 18%, one arrives at a potential annual loss of between R4.32 billion and R10.8 billion to the fiscus.

The Australian Tax Office has reported significant success in using data from AUSTRAC (Australia's Financial Intelligence Centre). The use of AUSTRAC data by the Tax Office has increased significantly in recent times with the renewed field focus on the cash economy. When comparing usage from 1999-2000 to 2002-03, there has been a 40% increase in the incidence of checking AUSTRAC data for casework. AUSTRAC reports indicate tax results achieved through the use of their data in the 2002-03 year amounted to AUS \$99.2 million in revenue (Austrac Annual report: 2003).

AUSTRAC data has also played a significant role in achieving the prosecution of several persons involved in significant tax avoidance activities. Profiling using the AUSTRAC database identified in one instance a building construction company making weekly cash withdrawals

totaling \$8M over a five-year period. These were checked against the taxpayer's records, which revealed that the withdrawals were recorded as purchases and supported by false invoices. Subsequent audit activity culminated in search warrants being executed and, as a result, the cash withdrawals were found to be untaxed cash payments to employees and subcontractors. Tax and penalties of \$3.2M were assessed and on prosecution, the directors pleaded guilty to fraud charges. The trial judge found that the directors had engaged in deliberate and systematic tax fraud. As a result, one director was sentenced to 18 months imprisonment and the other received a 12-month good behavior bond (Austrac Annual Report: 2003).

Chapter 9

Conclusion

The integrity of the banking and financial services marketplace depends heavily on the perception that it functions within a framework of high legal, professional and ethical standards. A reputation for integrity is the one of the most valuable assets of a financial institution. If funds from criminal activity can be easily processed through a particular institution - either because its employees or directors have been bribed or because the institution turns a blind eye to the criminal nature of such funds - the institution could be drawn into complicity with criminals and become part of the criminal network itself. Evidence of such complicity will have a damaging effect on the attitudes of other financial markets regulatory authorities, as well as ordinary customers.

As for the potential negative macroeconomic consequences of unchecked money laundering, the International Monetary Fund has cited inexplicable changes in money demand, prudential risks to bank soundness, contamination effects on legal financial transactions, and increased volatility

of international capital flows and exchange rates due to unanticipated cross-border asset transfers.

Such legislation is critical to South Africa's standing in the international community. The greater knowledge we have gained about money laundering over the past few years has confirmed that it is a dynamic activity, conducted with increasing sophistication. This knowledge has also confirmed that money laundering is not concerned with drug trafficking alone, but with any crime that generates significant proceeds, particularly when organized crime is involved. Money launderers have shown that they are responsive to countermeasures and is always searching for new laundering routes. This is why money laundering is not confined to the banking sector but can embrace the whole range of the financial sector and also spread into non-financial businesses of all sorts. Money laundering not only poses a threat to financial institutions, it is also part of a process that endangers the economy, society and eventually the country itself.

It is unrealistic to expect that money laundering can be eradicated. What can and is being done is to make money laundering more difficult and to increase the chance of money laundering being detected and caught if it is carried out. Putting in place an effective legal framework is an essential precondition for this. It must

also be recognized that it is interruption of the flow of funds that is likely to achieve the most effective results. The delaying of funds in transmission so as to cause liquidity problems for those engaged in operating a criminal enterprise is likely to be more effective in harming the criminal activity in question than in initiating difficult and expensive judicial proceedings which may or may not result in a forfeiture order.

South Africa has a comprehensive framework for money laundering control. The challenge that it now faces is to implement the system. If done correctly, the system could contribute to the development of the South African economy as well as the combating of crime in the country. It is clear that South Africa will be able to rely on the available international expertise in money laundering control in this process. However, South Africa faces many challenges that are foreign to developed economies, for instance those in respect of the abuse of its informal economy by launderers. South Africa will have to formulate its own answers and strategies in this regard. Greater cooperation between the countries in the region will enable South Africa and the other countries to pool their expertise and resources and to develop systems that will effectively address money laundering as it is manifested in their economies.

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Annexure 1

FINANCIAL INTELLIGENCE CENTRE

The following institutions are listed as **accountable institutions** in Schedule 1 to the Financial Intelligence Centre Act, 2001:

1. An attorney as defined in the Attorneys Act, 1979 (Act 53 of 1979).
2. A board of executors or a trust company or any other person that invests, keeps in safe custody, controls or administers trust property within the meaning of the Trust Property Control Act, 1988 (Act 57 of 1988).
3. An estate agent as defined in the Estate Agents Act, 1976 (Act 112 of 1976).
4. A financial instrument trader as defined in the Financial Markets Control Act, 1989 (Act 55 of 1989).
5. A management company registered in terms of the Unit Trusts Control Act, 1981 (Act 54 of 1981).
6. A person who carries on the ``business of a bank`` as defined in the Banks Act, 1990 (Act 94 of 1990).
7. A mutual bank as defined in the Mutual Banks Act, 1993 (Act 124 of 1993).
8. A person who carries on a ``long-term insurance business`` as defined in the Long-Term Insurance Act, 1998 (Act 52 of 1998), including an insurance broker and an agent of an insurer.
9. A person who carries on a business in respect of which a gambling licence is required to be issued by a provincial licensing authority.
10. A person who carries on the business of dealing in foreign exchange.
11. A person who carries on the business of lending money against the security of securities.
12. A person who carries on the business of rendering investment advice or investment broking services, including a public accountant as defined in the Public Accountants and Auditors Act, 1991 (Act 80 of 1991), who carries on such a business.
13. A person who issues, sells or redeems travellers' cheques, money orders or similar instruments.
14. The Postbank referred to in section 51 of the Postal Services Act, 1998 (Act 124 of 1998).
15. A member of a stock exchange licensed under the Stock Exchanges Control Act, 1985 (Act 1 of 1985).
16. The Ithala Development Finance Corporation Limited.

17. A person who has been approved or who falls within a category of persons approved by the Registrar of Stock Exchanges in terms of section 4 (1) (a) of the Stock Exchanges Control Act, 1985 (Act 1 of 1985).
18. A person who has been approved or who falls within a category of persons approved by the Registrar of Financial Markets in terms of section 5 (1) (a) of the Financial Markets Control Act, 1989 (Act 55 of 1989).
19. A person who carries on the business of a money remitter.